

The look-through approach to live on, but risks remain

By Taylor Schleich & Ethan Currie

- The Bank of Canada is set to leave its overnight target unchanged at 2.25%, a decision widely expected by forecasters and OIS markets. This would mark the fifth consecutive hold after policymakers first declared in October that policy is at “about the right level” to keep inflation near target and support the economy’s transition.
- After the April decision, OIS markets discounted more than 50 bps of Bank of Canada tightening in 2026. Weak economic and inflation data inter-meeting saw roughly half of this stripped out. We don’t expect rate expectations to be pared much further after the decision. The statement should reiterate that the Bank is still looking through the war’s immediate impact on inflation. They’ll also keep both hikes *and cuts* on the table. However, it’s the upside inflation/rate hike scenario that will, at least implicitly, be advanced as the more pressing risk. Note that both policy decisions since the onset of the Middle East war produced Canadian rate selloffs and underperformance vs. USTs.
- The statement will acknowledge weaker-than-expected GDP growth, though Macklem will be sure to stress this is not a recession. They may also point to an expected growth rebound in Q2. Despite strong job gains in May, they’ll reiterate that the labour market is “soft”.
- Despite the surge in gas prices, recent inflation data has been encouraging as underlying price pressures continue to cool. The Bank should (again) acknowledge that there’s little evidence of energy prices feeding through into inflation more broadly. However, they’ll (again) stress that they’re watching this carefully and that the risk of broadening rises the longer oil prices remain elevated.

Perspective on recent Bank of Canada rate decisions

Previous five BoC rate decisions and intra-day market reaction

Decision	Change	Rate	2Y yield	2Y: CA-US	10Y yield	CAD USD
Date	bps	%	bps	Bps	bps	%
10-Jun-26	0	2.25	-	-	-	-
29-Apr-26	0	2.25	11.9	9.4	4.9	0.1
18-Mar-26	0	2.25	2.1	2.3	2.0	0.1
28-Jan-26	0	2.25	-0.5	-0.9	0.5	-0.2
10-Dec-25	0	2.25	-4.1	-2.1	-4.8	0.1
29-Oct-25	-25	2.25	3.4	-2.6	4.7	0.0

Source: NBC, BBG | Note: Intraday chg. based on price/yield at 9:30AM & 12:00PM ET

How are the BoC’s latest forecasts shaping up?

BoC and NBC baseline forecasts for real GDP growth and CPI inflation

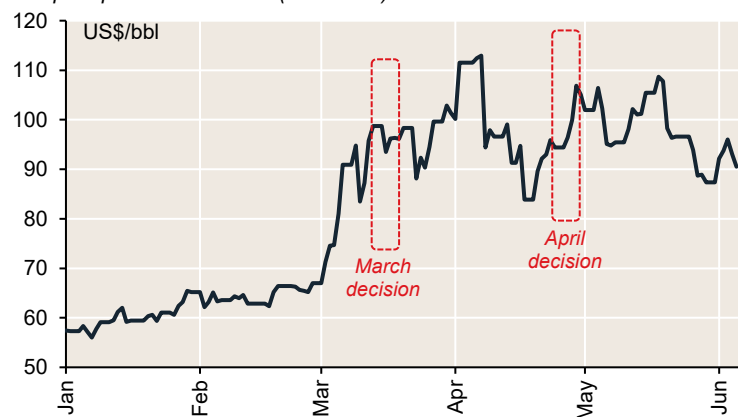
	Projection	Q4:25	Q1:26	Q2:26	2026
GDP	January MPR	0.0	1.8	-	1.1
	April MPR	-0.6	1.5	1.5	1.2
	NBC/Actual	-1.0	-0.1	2.3	0.7
CPI	January MPR	2.2	2.0	-	2.0
	April MPR	2.2	2.2	2.6	2.3
	NBC/Actual	2.2	2.2	2.9	2.7

Source: NBC, BoC | Note: Figures Y/Y except for quarterly GDP which is Q/Q SAAR.

Eyeing the evolving oil outlook: In the lead-up to the late-April Bank of Canada meeting, crude prices were rising quickly and surpassed \$100/bbl on decision day (both for WTI and Brent). Since then, oil prices have retreated moderately on optimism for a near-term peace deal.

Oil prices have moderated but remain elevated

WTI prompt futures contract (2026:YTD)



Source: NBC, Bloomberg

On the other hand, there’s been no relief in the prices for longer-dated crude futures. In the April MPR, the Bank assumed WTI would stabilize at \$70/bbl by mid-2027 and today, the futures strip is signalling something closer to \$75/bbl in year’s time. Taken together, it implies immediate term inflation risks are a bit better contained but there’s perhaps less runway

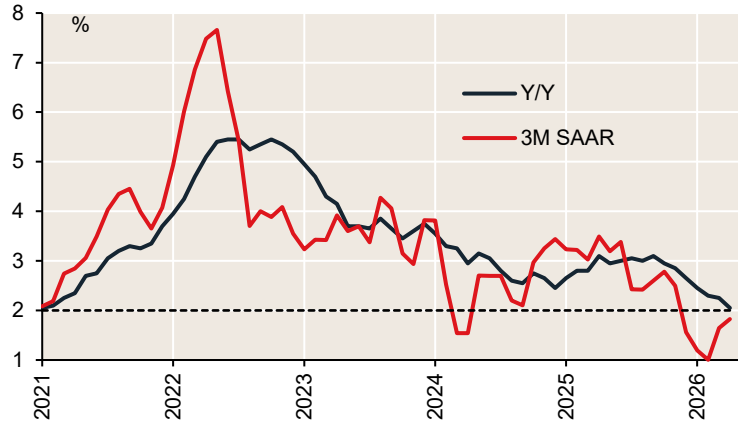
for disinflation later this year. Are these shifting dynamics enough to materially alter how Governing Council speaks to the rate path and balance of risks? Probably not. We expect GC to simply reiterate that the higher oil prices rise and/or the longer oil prices remain elevated, the greater the risk of inflation broadening.

Encouraging inflation (so far): Higher consumer price inflation was inevitable with gas prices surging in March/April. Fortunately, price pressures in the rest of the CPI basket have been more benign than expected, limiting the jump in overall inflation. Indeed, April’s 0.3%-pt downside surprise (which followed a 0.2%-pt downside miss in March) allowed all-items inflation to remain in the 1-3% control band. Where to from here? With gas prices rising in May, there’s a bit of inflation still in the pipeline and the headline gauge should hit 3%. However, that’s likely to represent CPI’s peak with gradual disinflation taking hold thereafter.

In gauging the policy rate path, the key is how higher energy costs impact the prices of other goods and services (read: core CPI). Through two months of the Middle East conflict, there’s not much evidence of price increases broadening. In April, the Bank’s preferred core measures reached a 63-month low of 2.05% Y/Y and the more traditional measure of core inflation—ex-food and energy—is even more becalmed at 1.5% Y/Y. What’s more, shorter-term measures of core inflation hint at a more recent loss momentum. So long as these dynamics persist, the Bank will be able to look through the energy-driven headline rise. And while there will inevitably be *some* broadening in the CPI—for example, airfares are set to increase on higher jet fuel prices—we expect this to be contained as excess economic capacity is limiting firms’ ability to pass on costs.

Limited evidence of energy prices broadening

Canadian inflation: Average of Bank of Canada's preferred core measures



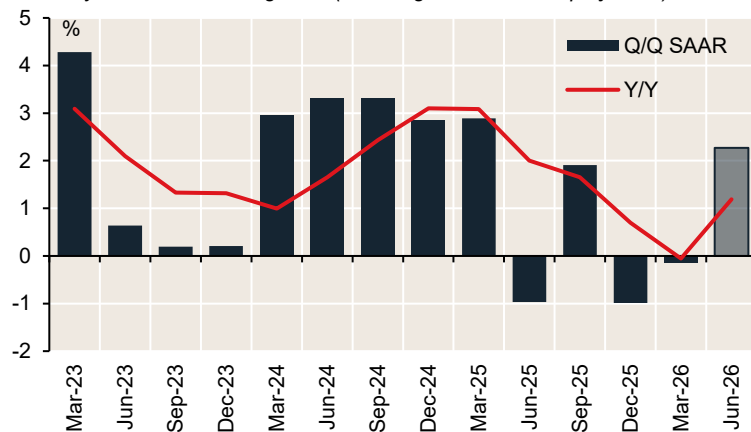
Source: NBC, StatCan

In April, the Bank explained they'll be closely monitoring inflation expectations. We'll have to wait until July's *Business Outlook Survey* for their preferred business and household gauges but the CFIB's monthly survey suggests near-term expectations are no worse than in April. Meantime, market-based measures of long-run inflation are still well anchored, little changed from 5-6 weeks ago.

Technical recession or not, slack persists: Headlines of "technical recession" dominated Canadian media at the end of May, as the economy registered two consecutive quarters of negative growth. We'd push back against this characterization given that: (1) the Q1 contraction was tiny (-0.1% SAAR); (2) the decline in the population was even sharper (leaving GDP per capita at +0.9% SAAR); and (3) recent performance doesn't reflect a pronounced, persistent, and pervasive decline in real economic activity (a more appropriate recession definition). But even if one were to *still* deem this a recession, it's clear it'll be a short-lived one. StatCan's flash estimate for a 0.4% m/m expansion in April leaves us projecting Q2 GDP growth north of 2%.

Technical recession to be short-lived

Quarterly and annual GDP growth (including NBC 2026: Q2 projection)



Source: NBC, StatCan | Note: 2026: Q2/Jun-26 = NBC projection.

Expect the Bank to downplay recession chatter on Wednesday too. Senior Deputy Governor Carolyn Rogers did just this already, saying one must "look past" the technical recession indicator while pointing to an expected Q2 rebound. At the same time, they will need to acknowledge that the economy is weaker than they'd anticipated. In April, Macklem said "growth looks to have resumed after contracting at the end of 2025". He also added that slightly above potential growth will see slack "slowly

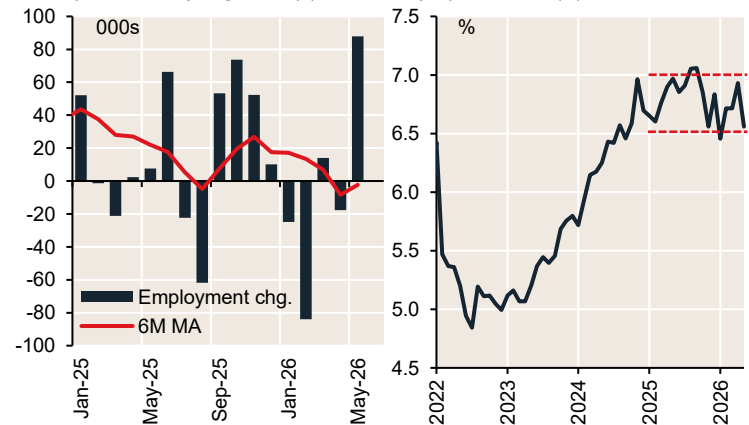
absorbed". They'll still hold this view but clearly, the slack absorption timeline has been delayed (at least by a quarter).

Despite May hiring surge, labour market still soft: Job growth in May was the fastest since in 17 months, but as any Canadian economist will stress, don't put too much stock into one month of the LFS. Certainly, don't take one month and project that forward. To us, earlier jobs data were overstating weakness, but year-to-date performance is now better characterizing the state of the labour markets. Indeed, average job growth in 2026 is effectively zero (-5K/month) and the unemployment has been rangebound (between 6.5% and 7.0%). In other words, it's a low hire, low fire environment where conditions aren't improving but they also aren't getting materially worse.

In late April, the Bank of Canada simply described the labour market as being "soft". That characterization won't change after May's hiring surge. Moreover, we don't expect the central bank to express much optimism about trajectory of the job market from here. Downside risks to employment remain due trade/USMCA uncertainty and forward-looking measures of labour demand (i.e., job vacancies) remain subdued.

BoC's 'soft' job market assessment to remain intact

Monthly Canadian job growth (L) and unemployment rate (R)



Source: NBC, StatCan

Still 'looking through' war's inflation impact: At the last two meetings, the Bank said it was looking through the war's "immediate impact on inflation." We expect that language to survive as, with only March and April data available, the Bank can still frame the inflation impulse as immediate. By July, however, the focus may need to shift toward their assessment of inflation persistence and second-round effects.

In late April, Macklem said the baseline outlook was consistent with a "policy rate close to the current setting," though "small" changes could be required. Given the target rate is slightly below the neutral mid-point, we see "small" adjustments as skewed more toward hikes. But while oil prices and inflation expectations have remained elevated since April, weaker economic data are moderating ongoing inflation risks. The Bank may reiterate that adjustments could be needed, but we see a near-term rate change (small or otherwise) as unlikely.

Attracting the most attention last meeting was Macklem's threat of "consecutive" rate hikes if oil prices rise further, remain elevated and broaden. Less noted was the Bank's 'cut scenario,' in which significant new tariffs are levied. The Bank will leave both options on the table Wednesday. To us, the hike scenario is less likely given ongoing economic weakness and well-contained core inflation, and the Bank *could* say as much. But while we think that's justified, BoC decisions have leaned hawkish since the conflict began. Canadian rates sold off and underperformed Treasuries after the March and April announcements, so don't be surprised if policymakers retain a more defensive, hawkish bias.



Latest policy statement: April 29, 2026

Bank of Canada maintains policy rate at 2¼%

The Bank of Canada today held its target for the overnight rate at 2.25%, with the Bank Rate at 2.5% and the deposit rate at 2.20%.

The evolving conflict in the Middle East is causing heightened volatility and US trade policy continues to reshape global trade patterns. Both are ongoing sources of uncertainty. The Bank's April outlook assumes tariffs remain unchanged and the global benchmark price of oil declines to US\$75 per barrel by mid 2027.

The Iran war has led to sharply higher energy prices and transportation disruptions, diminishing growth prospects in oil-importing countries and boosting inflation worldwide. In the United States, growth is still expected to be solid over the projection horizon, boosted by AI-related investment and consumption growth. China's economy is being supported by robust exports. In the euro area, higher prices for oil and natural gas will weigh on economic activity.

Financial conditions have been volatile, reflecting daily developments in the Middle East and shifting market expectations for inflation and interest rates. Bond yields are modestly higher since January while equity markets, which weakened sharply at the outset of the war, have recovered. Since the start of the war, the US dollar has appreciated against most major currencies. The Canada-US exchange rate has been relatively stable.

Overall, the global economy is expected to grow by about 3% in 2026, 2027 and 2028. Projections for inflation over the next year are revised up because of the jump in energy prices.

The outlook for economic growth in Canada is little changed from the January Monetary Policy Report (MPR) projection. After a contraction in the fourth quarter of 2025, growth is forecast to have resumed in early 2026. Consumer and government spending are supporting economic activity, while tariffs and trade uncertainty are weighing on exports and business investment. Housing activity declined in the fourth quarter and is being held back by slow population growth, economic uncertainty and ongoing affordability issues. The labour market is soft, with subdued employment growth over the past year and job losses in sectors targeted by US tariffs. The unemployment rate remains in the 6½%-7% range, reflecting both weak hiring and fewer job seekers.

The Bank's April forecast projects GDP growth of 1.2% in 2026, rising to 1.6% in 2027 and 1.7% in 2028 as growth in exports and business investment resumes along a lower trajectory. With GDP growing slightly above potential, the current excess supply in the economy is gradually absorbed. While the war in Iran may alter its composition, overall GDP growth is little changed in the updated forecast: Since Canada is a large net exporter of oil, higher oil prices increase national income even as consumers are squeezed by higher gasoline prices.

CPI inflation climbed to 2.4% in March because of sharply higher gasoline prices. The March increase follows several months of slowing inflation data. Core inflation has been easing and held steady at just above 2% in the most recent inflation report. The proportion of components of the CPI basket rising above 3% has also declined in recent months. As expected, so far there is little evidence that oil prices have fed through more broadly to goods and services prices, but this warrants close attention in the months ahead. Near-term inflation expectations have moved up with higher gasoline prices and still-elevated food price inflation, but longer-term inflation expectations have remained anchored.

CPI inflation will likely rise further in April to about 3%. Based on the assumption that oil prices will ease, inflation is forecast to come down to the 2% target early next year and remain around 2% over the projection horizon.

Against this backdrop and taking into account the current projection, Governing Council decided to maintain the policy rate at 2.25%. We are closely monitoring the impact of the conflict in the Middle East and how the economy is responding to US tariffs and trade policy uncertainty. Governing Council is looking through the war's immediate impact on inflation but will not let higher energy prices become persistent inflation. As the outlook evolves, we stand ready to respond as needed. The Bank is committed to maintaining Canadians' confidence in price stability through this period of global upheaval.

Information note

The next scheduled date for announcing the overnight rate target is June 10, 2026. The Bank's next MPR will be released on July 15, 2026.

Source: Bank of Canada



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